

**REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE GAMAGARA LOCAL MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I was engaged to audit the financial statements of the Gamagara Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer opinion

Property, plant and equipment

4. Property plant and equipment disclosed as R957 761 652 in note 8 to the financial statements were misstated due to the following matters;
 - Property plant and equipment reflected as R7 797 922 on the project list and property plant and equipment on the valuation roll reflected as R748 000 were not included in the asset register.
 - Investment property reflected as R382 361 was incorrectly disclosed as property plant and equipment.
 - Property plant and equipment reflected as R1 285 411 that was damaged during the strikes in Olifanthoek was not impaired.
 - Property plant and equipment reflected as R189 000 was disclosed as non-current assets held for sale as well as property plant and equipment.
 - The municipality did not review the residual values and useful lives of property plant and equipment at each reporting date in accordance with Standard of Generally Recognised Accounting Practice, GRAP 17, Property, plant and equipment. Property plant and equipment were included in the financial statements at a zero net carrying amount while it was still in use. I have not determined the correct net carrying amount of these assets as it was impracticable to do so.
 - Other assets reflected as R712 300 was incorrectly disclosed as land.
5. In addition, I was unable to obtain sufficient appropriate audit evidence for property plant and equipment. I was unable to confirm these items by alternative means. Consequently I was unable to determine whether any adjustments to property plant and equipment were necessary.

Expenditure

6. The amounts disclosed for depreciation and amortisation reflected as R20 285 462 in note 28 do not agree with the amount reflected as R21 647 649 in the asset register, resulting in depreciation and amortisation being understated by R1 362 187. In addition to this, I was unable to obtain sufficient appropriate audit evidence for expenditure transactions relating to repairs and maintenance, employee-related cost, finance cost, bulk purchases, contracted services and general expenditure. The municipality did not have adequate systems in place to maintain records of expenditure transactions. I was unable to confirm these expenditure line items by alternative means. Consequently, I was unable to determine whether any adjustments to these expenditure line items were necessary.

Government grants and subsidies received

7. I was unable to obtain sufficient appropriate audit evidence for transactions posted against government grants and subsidies received disclosed as R61 078 247 in note 20 to the financial statements. I was unable to confirm these transactions by alternative means. Consequently, I was unable to determine whether any adjustments to government grants and subsidies received were necessary.

Commitments

8. I was unable to obtain sufficient appropriate audit evidence for commitments disclosed as R24 366 425 in note 41 to the financial statements. The municipality did not have adequate systems in place to maintain records of commitments. I was unable to confirm these commitments by alternative means. Consequently, I was unable to determine whether any adjustments to these expenditure line items were necessary.

Payables

9. I was unable to obtain sufficient appropriate audit evidence for transactions posted against payables disclosed as R12 199 880 in note 12 to the financial statements. I was unable to confirm these transactions processed by alternative means. Consequently, I was unable to determine whether any adjustments to payables were necessary.

Irregular expenditure

10. The municipality made payments in contravention of the supply chain management requirements which were not included in irregular expenditure as required by section 40(3)(i) of the MFMA, resulting in irregular expenditure being understated by R40 829 446.

Unauthorised expenditure

11. The municipality overspent their budget by R15 831 999. The municipality did not disclose any unauthorised expenditure, resulting in unauthorised expenditure being understated by R15 831 999.

Cash flow statement

12. The net cash flows from operating activities reflected as R29 559 093 in the cash flow statement did not agree with the amounts totalling R11 884 976 as reflected on the referencing note. I was unable to confirm these differences by alternative means. Consequently, I was unable to determine whether any adjustments to the cash flow statement were necessary.

Presentation and disclosure

13. GRAP 104, *Financial instruments*, was issued in October 2009 but is not yet effective. The municipality did not adopt GRAP 104 early. The municipality made the disclosure of financial instruments in note 41 in line with GRAP 104 while the accounting policy states that financial instruments will be disclosed in line with International Accounting Standards (IAS) 32 and 39 and International Financial Reporting Standard (IFRS) 7.
14. Distribution losses for water and electricity were not disclosed, as required by section 125(2d)(i) of the MFMA. I have not determined the amount of these losses as it was impracticable to do so.

Disclaimer of Opinion

15. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

17. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an error discovered during 30 June 2012 in the financial statements of the Gamagara municipality at, and for the year ended, 30 June 2011.

Material losses and impairments

18. The municipality had receivables for exchange transaction totalling R17,3 million (64%) at 30 June 2012, which had been outstanding for more than 90 days. An amount of R14,9 million of this amount was disclosed as a provision for impairment. The recoverability of these amounts is doubtful.

Additional matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material inconsistencies in other information included in the annual report

20. The 2011-12 annual report has not been received at the date of this report. As a result, a conclusion could not be reached on the consistency between the financial statements and the audit report with other information included in the annual report.

Unaudited supplementary schedules

21. The supplementary information set out on appendices A to F does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

22. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

23. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
24. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information* (FMPPI).

The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

25. The material findings are as follows:

Usefulness of information

Presentation

26. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 65% measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures due to limitations placed on the scope of my work by the municipality. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy, completeness of the measures taken to improve performance.

Consistency

27. Section 41(c) of the MSA requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators, targets are not consistent with the objectives, indicators, targets as per the service delivery and budget implementation plan (SDBIP). This is due to the lack of insight on performance information by management and thus no review of the alignment between and SDBIP and IDP was performed.

Measurability

28. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 67% of the targets relevant to development priority – Basic services and infrastructure development. This was due to the fact that management was aware of the requirements of the FMPPI but chose not to apply the principles contained in the FMPPI.

29. The FMPPI requires that the time period or deadline for delivery be specified. A total of 56% of the targets relevant to development priority 1 – Basic services and infrastructure development were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but chose not to apply the principles contained in the FMPPI.

30. The FMPPI requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators, measures relevant to development priority 1 – Basic services and infrastructure development were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but chose not to apply the principles contained in the FMPPI.

31. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the indicators, measures relevant to development priority 1 – Basic services and infrastructure development were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to management was aware of the requirements of the FMPPI but chose not to apply the principles contained in the FMPPI.

Relevance

32. The FMPPI requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. A total of 33% of indicators, measures did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the three-year strategic plan. This was due to the lack of development and implementation of proper performance planning

and management practices to provide for the development of performance indicators and targets included in the integrated development plan.

Reliability of information

Validity

33. The FMPPI requires that processes and systems which produce the indicator should be verifiable. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity of the actual reported performance relevant to 100% of development priority 1 – Basic services and infrastructure development. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures.

Accuracy

34. The FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy of the actual reported performance relevant to 100% of development priority 1 – Basic services and infrastructure development. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures

Completeness

35. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant 100% of development priority 1 – Basic services and infrastructure development. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures

Additional matters

36. I draw attention to the following matters below. These matters do not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

37. Of the total number of planned targets, only 16 were reached during the year under review. This represents 70% of total planned targets that were not achieved during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

Service delivery protests

38. The protests and associated service delivery issues in Olifantshoek have dominated national media interest in the recent months. Limited services have been provided to the community since May 2012.

Compliance with laws and regulations

39. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Strategic planning and performance management

40. The performance audit committee did not meet at least twice during the financial year, as required by Municipal Planning and Performance Management Regulation 14(3)(a).
41. The performance audit committee did not review the municipality's performance management system or make recommendations to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(ii).

42. The performance audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(i).
43. The performance audit committee did not submit at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(iii).

Annual financial statements, performance and annual reports

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.
45. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46(1)(a-c) of the MSA.

Revenue management

46. Interest was not charged on all accounts in arrears as, required by section 64(2)(g) of the MFMA.
47. Revenue received for rental of facilities and traffic fines was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.

Assets management

48. An effective system of internal control for assets, including an asset register, was not in place, as required by section 63(2)(c) and 96(2)(b) of the MFMA.
49. An adequate management, accounting and information system which accounts for assets was not in place, as required by sections 63(2)(a) and 96(2)(a) of the MFMA.
50. Some assets were not transferred to Gamagara municipality as required by section 16 of the Deeds Registries Act, 1937 (Act No. 47 of 1937).

Audit committees

51. A shared audit committee was not in place for four months of the financial year, as required by section 166(1) of the MFMA.
52. The shared audit committee was not constituted, as required by section 166(4)(a) MFMA as the following requirements were not adhered to:
 - At the beginning of the financial year the shared audit committee consisted of four members. Two of the members resigned in September and October 2011. The committee was eventually dissolved on 29 February 2012. Therefore three members were not appointed as required throughout the year.
53. The shared audit committee did not advise the accounting officer on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management or performance evaluation as required by section 166(2)(a) of the MFMA.
54. The shared audit committee did not advise the accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.

55. The shared audit committee did not advise the accounting officer on matters relating to compliance with the MFMA, and DoRA, as required by section 166(2)(a)(vii) of the MFMA.
56. The shared audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with the MFMA and DoRA, as required by section 166(2)(b) of the MFMA.
57. The shared audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
58. The shared audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

59. The shared internal audit unit did not function as required by section 165(2) of the MFMA, in that:
 - it did not report to the audit committee on the implementation of the internal audit plan
 - it did not advise the accounting officer or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
60. The shared internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.
61. The shared internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MFMA and Municipal Planning and Performance Management Regulation 14(1)(a).
62. The shared internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA, the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators], as required by Municipal Planning and Performance Management Regulation 14(1)(b).
63. The shared internal audit unit did not audit the performance measurements on a continuous basis and/or submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14(1)(c).

Procurement and contract management

64. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
65. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulation 19(a) and 36(1).
66. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
67. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).

68. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of Preferential Procurement Policy Framework Act.
69. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA
70. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
71. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
72. Awards were made to providers who are persons in service of other state institutions, in contravention of SCM regulations 44.
73. A list of accredited prospective providers was not compiled per commodity and per type of service in accordance with SCM regulation 14(3).

Expenditure management

74. Sufficient appropriate audit evidence could not be obtained that money owing by the municipality had always been paid within 30 days of receiving an invoice or statement, as required by sections 65(2)(e) and 99(2)(b) of the MFMA.
75. The accounting officer did not take reasonable steps to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.
76. Payments were made without the approval of the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.

Internal control

27. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

77. The leadership did not adhere to the supply chain management (SCM) policy in place at the municipality, which resulted in processes not preventing and detecting the irregular expenditure and non-compliance.
78. Senior management did not respect and adhere to internal controls, which resulted in unauthorised and irregular expenditure being incurred and not detected by management.
79. The municipality did not have policies relating to IT security in place during the financial year.
80. The accounting officer did not evaluate whether management has implemented effective internal controls by gaining an understanding of how senior management has met its responsibilities.

Financial and performance management

81. Management did not perform a proper review on the financial statements compiled by external service providers, which resulted in material amendments to the financial statements to ensure fair presentation of the financial statements.
82. The municipality's delegated employee did not review and monitor compliance with applicable laws and regulations.
83. In the absence of appropriate pre-determined objectives training to the municipal staff, management appointed external service providers to compile an annual performance report, however, the contract with the consultants was only renewed after year-end, which resulted in the performance of the municipality against pre-determined objectives not being monitored.

84. There are deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations and performance information.

Governance

85. The municipality utilised the shared internal audit division within John Taolo Gaetsewe District Municipality. The internal audit unit did not follow a risk-based approach in selecting components to be audited and did not use a systematic method to select samples. Performance information was not audited by the shared internal audit during the 2010-11 and 2011-12 financial years.
86. The municipality utilised the shared audit committee within John Taolo Gaetsewe District Municipality. Although the audit committee did function throughout the year, it did not fulfil all its responsibilities. The audit committee did not review the financial statements of the various municipalities in the district before it was submitted to the external auditors. The audit committee did not review the performance management systems and did not make recommendations to the councils in this regard.

OTHER REPORTS

Investigations

87. An investigation is being conducted to probe allegations made by the public relating to mismanagement. The investigation aims to establish whether these allegations are true. The investigation was still ongoing at the date of this report.

Auditor - General

Kimberley

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence